As discussed below, Western's Petition is comprised of false assertions and mischaracterizations of the facts. As such it should not be given any credence by the Commission. If there are areas raised in the Petition that the Commission wishes to investigate, existing proceedings should be used. For instance, the cost basis of, and the size of the federal high cost funds are currently at issue in CC Docket 96-45.

1. **Save Money**. By far the largest cause of the growth of the high-cost universal service fund is disbursements to rural ILECs pursuant to ROR formulas. Consumers across the country would save hundreds of millions, possibly billions, of dollars if ROR were eliminated and replaced with a system better targeted to support affordable service for consumers in high-cost areas.

- **Consumers will not save millions or billions if actual (embedded) cost rate of return (ROR) based federal support for rural ILECs were eliminated. If support were based on a hypothetical ROR model of costs and if the model and its inputs were designed to reduce support for rural ILEC areas, rural consumers throughout the nation would be the losers.**
- **The Petition, if granted, would cause the Commission to create a service and digital divide between rural and urban areas by providing insufficient support. The Commission should reject the Petition and continue the current support mechanism which provides sufficient support (see Tab 2) to allow rural carriers to provide affordable and quality basic and advanced facilities and services that are comparable to those found in urban areas, as required by the Act.**
- **Rural ILECs are the only carriers that now provide affordable and quality basic universal services and advanced services with modern and efficient facilities to all consumers in rural areas.**
- **Intermodal competition exists (see Tab 3), but this competition does not provide quality basic service to all consumers. There are major areas where service is not provided (see Tab 4), and even where service is provided, calls are frequently dropped and service quality is poor (static, one party can hear but the other party can't, etc.).**
- **It is unlikely that intermodal competitors will ever provide quality basic and advanced service to all rural consumers, as do the rural ILECs, even with support because of the limitations of the technology used (terrain considerations, etc.). In fact, consumers use intermodal competitive services as an adjunct to, not a replacement for, existing wireline basic local services.**
- **The Commission should not risk the advances made in providing quality basic and advanced service to consumers in rural ILEC areas by giving credence to, and considering, in a separate proceeding, the specious assertions in the Western Wireless Petition.**

2. __Stop Waste, Fraud and Abuse__. Regulators and independent auditors rarely, if ever, look at the accounting books of most ROR carriers, and opportunities abound for carriers to overstate their costs and thereby increase their access charges and high-cost support. The Supreme Court recognized that the ILECs' "book costs may be overstated by approximately $5 Billion." [*Verizon v. FCC*, 535 U.S. 467, 518 (2002)]

- **There is no waste, fraud and abuse as Western alleges in its Petition. To attempt to bolster its false claims, Western cites a number of cases involving price cap RBOCs and audits of rural ILECs in Kansas.**
- **The cases cited by Western involving RBOCs have no relevance to rural ILECs. The RBOCs are price cap, not ROR regulated carriers and their actions and incentives under price cap regulation have no bearing on rural ROR ILEC actions.**
- **In the only instance cited by Western that involves rural ILECs (Kansas), there has been no finding by the Kansas Commission of "waste, fraud or abuse." In fact, there is none to find. Western uses information from the Kansas audits (in Western's Attachment A) to misrepresent the facts of these audits. What Western doesn't explain to the Commission is that the reduction in intrastate revenue is in large part due to differences in ratemaking philosophies between the federal and intrastate jurisdictions. For instance, costs allowed in the federal jurisdiction and properly booked per Part 32 (accounting) and allocated per Part 36 (separations) of the FCC's Rules and Regulations such as plant under construction, charitable contributions, etc., are disallowed in whole or in part by many state commissions, including the Kansas Commission. Commissions, including Kansas, also establish a rate of return to be used that differs from the federal return and that is often company specific. The types of adjustments made are shown in Tab 5.**
- **The Kansas Commission disallowances and changes to the rate of return (as well as other similar adjustments), not the "waste, fraud and abuses" claimed by Western, have resulted in the audit results discussed by Western for the Kansas companies in Western's Petition, Attachment A. Many rural ILECs in Kansas, that understood these ratemaking philosophies and the accompanying state commission adjustments that were inevitable in an audit, elected to avoid the high cost of a full audit and enter into a stipulation with the Commission. These stipulations are a standard practice and are not evidence of "waste, fraud and abuse" as implied by Western, but are an attempt by the ILEC and the state commission to avoid the needless expenditure of unnecessary costs.**
- **Rather than attempting to increase access charges, as Western alleges, rural ILECs have no incentive to increase these rates and many rural ILECs are attempting to reduce these charges to assist in the provision of toll and expanded calling services in rural areas that are comparable to those in urban areas. This is the case in Kansas, where the rural ILECs worked with the Kansas Commission on a plan that reduced access rates over a transitional period. Rural ILECs in Oklahoma may follow a similar path.**
- **Rural ILECs also have no incentive to increase high cost support beyond the level necessary to recover their high loop and local switching costs. These**

facility costs, which now are largely fiber based for loop and are transitioning to the most efficient switching technology, are the major components of high cost support. These facilities are the essential component not only for all carriers, including Western (although it seldom pays for their use) to interconnect with consumers in rural areas. Needlessly increasing these costs puts pressure on the sustainability of these funds, at odds with the incentives of rural ILECs.

- **Western's Petition in an attempt to divert the Commission's attention from the fact that CMRS Eligible Telecommunications Carriers (ETCs) are themselves abusing federal and state support funding. In some cases, CMRS ETC carriers are directly misrepresenting facts and abusing these funds, as is the case with Western in Kansas (see Tab 6). In other cases, the CMRS ETC carriers are abusing the funds by receiving unwarranted funding that is unneeded to support their costs (see Tab 7). Wireless carriers are receiving these support funds, even though (at odds with the Act) their service rates and included local usage do not meet any reasonable affordability standard (see Tab 8), and the funding is not required to support their costs.**

3. **Prevent Cross-Subsidies and Cost Misallocation.** In the few cases where the FCC or a state commission examined carriers cost submissions, they found millions of dollars of misallocated costs, including costs of unregulated affiliates assigned to the ILEC in order to inflate high-cost support. In most cases, the FCC may lack authority to order remedies for such over-earnings. "In an era of corporate governance problems and accounting depredations," [Adelstein/Copps statement, FCC 03-111, 5/19/03], the FCC should change the rules to eliminate the rewards for such anti-competitive misconduct.

- **This allegation is a mischaracterization of the facts and is untrue. Most rural ILECs scrupulously assign costs to non-regulated operations in accordance with Commission rules. An example of the types of procedures followed to insure that these costs are properly assigned is included in Tab 9.**
- **Misallocations that have been found (as has been the case in Kansas) are primarily due to a misunderstanding of the costing rules or differences of opinion between the Commission and the ILEC.**
- **Again, this appears to be an attempt by Western to divert attention from the fact that CMRS ETC carriers are receiving unneeded funding for costs that include many questionable expenditures and ventures that have nothing to do with provision of basic universal service. For instance Western's international service; naming of major league ball fields, repurchasing of stock, paying off debt for acquisitions, etc. The use of support funding for these purposes benefits CMRS stockholders, but it does not benefit consumers.**

4. **Create Incentives for Efficiency.** ROR regulation gives carriers incentives "to adopt the most costly, rather than the most efficient, investment strategies," [3 FCC Rcd 3195, 3219-20]. Ending ROR would create incentives for more efficient networks, and would benefit consumers.

- **It is costly to provide high quality fiber based service to all consumers in rural ILEC service areas. Rural ILECs are providing these facilities so that all rural consumers they serve will have the capability to receive both basic and advanced services at affordable rate levels.**
- **ROR regulation has facilitated the rural ILECs ability to provide these services to consumers. Elimination of the rate of return based funding sources would, at odds with Western's assertion, eliminate the ability of rural ILECs to build efficient networks and would harm rural consumers.**
- **Rural ILECs have built and upgraded these networks to be efficient and state of the art with the help of lenders such as Co Bank, RUS, etc.**
- **These lenders would not provide funding to the rural ILECs for network for speculative and inefficient ventures.**
- **The rural ILECs have nothing to apologize for with regard to the networks they have built – they are modern, efficient and state of the art and provide consumers in rural areas with access to excellent basic and advanced services.**
- **Again CMRS carriers may wish to look inward to their investment strategies if they want to discuss efficiency. The service they provide is anything but high quality and efficient, particularly in rural areas.**

5. **Enhance Incentives for Innovation.** The FCC has recognized that ROR "may have a negative effect on innovation . . . . because a carrier's reward for such innovation is a reduction in its dollar earnings." [3 FCC Rcd 3195, 3223]. Eliminating ROR regulation would enhance incentives to speed the deployment of new technologies, benefitting rural consumers.

- **The "may have" in the FCC's quote is the operative phrase. An evaluation of the reality of the elimination of ROR regulation and its replacement with price cap regulation and TELRIC based rates and support for large wireline carriers is that:**
  a. **They have laid off thousands of employees in order to reduce costs and increase earnings.**
  b. **They have further reduced other costs (employee benefits, lighting, building and facility maintenance, etc) in order to increase earnings.**
  c. **Capital expenditures have been severely curtailed to the point where it is exceedingly difficult to have necessary trunk facilities added when the existing trunks exhaust.**
  d. **There are few, if any, capital expenditures to upgrade rural facilities or to provide facilities necessary to deliver advanced services in rural areas served by the price cap carrier.**
- **The reality is that where ROR regulation has been eliminated, the incentive is to reduce costs to increase revenues. In the process rural areas served by price cap carriers have not been the recipient of innovation and have in fact**

been left behind in the provision of digital services. There has certainly not been a rush to deploy new technologies that benefit consumers as asserted by Western. Even CMRS carriers are not expending the funds to deploy even basic service to all rural areas.

6. **Remove Barriers to Competition in Rural Areas.** Rural customers benefit from access to competitive telecom alternatives, but ROR regulation is a barrier to full competition. ROR targets RLECs' revenues to achieve a guaranteed return on investment on all historical costs incurred, while the RLECs' competitors receive portable funding only if they can obtain ETC designation, and even then only with respect to the lines that they provide – and unlike the RLECs, competitive carriers' investments are at risk.

- **This is a tired assertion that has no factual basis. As Tab 3 shows, there is significant competition in rural ILEC areas from CMRS carriers. In addition there is competition from satellite service providers and increasing competition from cable providers. Wireline ROR regulation has not been a barrier to any of these intermodal competitors.**
- **Even if they don't need the support and even if the support benefits their stockholders and not consumers, CMRS carriers are permitted to receive support based on rural ILEC costs, and thus support is not a barrier to entry.**
- **Finally, ROR regulation is not a guarantee of cost recovery as implied by Western Wireless. Commissions must approve tariffed rate levels and may review a ROR carrier's costs. If there is a downturn in the economy and revenues are lost or if, as is often the case, a Commission does not approve a rate increase, the rural ILEC may not have sufficient revenues to cover its costs. As a result, rural ILECs, like any prudent business, are efficient in the costs they incur and the facilities they build.**

7. **Fix Distorted Intercarrier Compensation.** Eliminating ROR would enable the FCC to remove implicit subsidies from the RLECs' access rates, as the Act requires.The RLECs' current, unreasonably high access charges distort local and long-distance competition in rural areas, deprive rural consumers of access to long-distance alternatives, and interfere with the development of a comprehensive, rational system of intercarrier compensation.

- **Considering the fact that most CMRS carriers, including Western Wireless are avoiding paying either access charges or local reciprocal compensation, this should not be a concern for Western Wireless.**
- **Implicit support (recovery of loop related costs) has been removed by the Commission from access charges. The resulting rate levels are not "unreason ably" high as asserted by Western, but recover costs used by IXCs and CMRS carriers for the use of rural ILEC facilities to originate and complete their interexchange and InterMTA calls, respectively.**
- **It is not the differing access and local compensation rate levels that is distorting competition in rural areas, but the Commission's differing definition of local calling (and thus where the local charges apply) for CMRS (IntraMTA) and for IXCs (interexchange).**

- **This differing definition has caused CMRS carriers to obtain a competitive advantage vis-à-vis the IXCs. CMRS carriers are allowed carry interexchange calls within the MTA and to pay a lower compensation (often bill and keep because the CMRS carriers avoid paying), even though with equal access, those calls should belong to the presubscribed IXC.**
- **Western Wireless is likely not really concerned with interexchange competition and the welfare of customers making those calls, because CMRS carriers have opposed equal access wireless competition that would benefit customers (see a discussion of CMRS equal access in Tab 10).**

8. **Rationalize and Modernize High-Cost Support.** The current high-cost support system is an irrational hodge-podge that gives rural ILECs vastly more support than larger carriers for serving identical geographic areas, rewards them simply for being small, and ignores whether they are efficient or not. The ROR paradigm must be replaced with a competitively neutral system that ensures "sufficient funding of *customers*, not *providers*," as the 1996 Act requires. [*Alenco*, 201 F.3d 608, 620 (5th Cir. 2000).]

- **Western's comments here are a complete misrepresentation and distortion of the facts. The current high cost system is not an irrational hodge-podge for rural ILEC ROR carriers. The differing high cost support mechanisms support differing facilities (switching or loop) in the rural ILECs network. The objective of these high cost funds is to insure that all consumers in rural areas have access at affordable rates to basic local exchange universal services. Other support funds support educational and health care goals or insure that low income customers have access to local service.**
- **Western also misrepresents the facts regarding the support levels received by large and small carriers. There are two basic reasons for this difference:**
  a. **The Commission uses a TELRIC methodology to determine the support for large wireline carriers. For consideration in other areas, many of the large carriers supported this methodology, even though it does not reflect the real costs they incur to provide rural service.**
  b. **High-cost support is determined at the study area level. For rural ILECs, this fairly reflects their rural cost characteristics and high costs. However, for large RBOCs that serve both urban low cost and rural high cost areas, this study area averaging of low and high costs eliminates much of the support that they would qualify for if their rural areas were analyzed separately from their urban areas. In effect, the RBOCs continue to implicitly support their high rural costs from their urban customers. Information that thoroughly evaluated and analyzed this intracompany urban to rural support was filed with the Commission and Joint Board by SBC in past rounds of universal service comments.**
- **The differences, at odds with Western's inferences, have nothing to do with differences in efficiencies between rural ROR and large Price Cap carriers, but are caused by the application of TELRIC to price cap carriers and by determining support at the study area average level.**

9. **<u>Remedy Unhealthy Dependence of RLEC Sector</u>.** Many RLECs receive 70% or more of their funding from universal service subsidies or intercarrier payments, rather than from their own customers. This unhealthy dependence insulates these carriers from any incentive to be responsive to their own consumers' needs. Eliminating ROR and rebalancing rates would put these carriers on a healthier financial footing.

   - **The ILECs have no objection to rebalancing as long as rates remain affordable and comparable to those in urban areas. To insure parity with statewide local rate levels for comparable services, the ILECs have rebalanced rates in Kansas and are considering a similar approach in Oklahoma. At the federal level, the subscriber line charge was a form of rebalancing.**
   - **However, rebalancing rates to the extent that would be necessary to reduce access and the universal service support, as Western suggests, would result in unaffordable rate levels for customers (see Tab 2).**
   - **The rural ILECs do not have an unhealthy dependence on either access charges or support funds. The facts are that if affordable local rates are to be made available to consumers in rural areas, the high costs to provide service in those areas requires these sources of funds in order to recover the ILECs costs.**

10. **<u>The FCC Was Correct and Should Keep Its Promises</u>.** In the 2001 *RTF Order*, the FCC reaffirmed its 1997 commitment to adopting forward-looking cost-based support mechanisms for rural carriers. It is time for the Commission to deliver on this worthy commitment.

   - **The FCC should not give Western's false and misleading assertions credence by creating a separate proceeding for Western's petition.**
   - **The Commission should use existing proceedings and the timing it established to evaluate costing for all ETC, universal service funding methodologies, etc.**